

AUG 31 1995

CLERK

No. 94-1175

*In The***Supreme Court of the United States**

OCTOBER TERM, 1995

BANK ONE, CHICAGO, N.A.,

Petitioner.

v.

MIDWEST BANK & TRUST COMPANY,

Respondent.

**ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT**

BRIEF FOR THE PETITIONER

JEFFREY S. BLUMENTHAL
KAMM & SHAPIRO, LTD.
Suite 1100
230 West Monroe Street
Chicago, Illinois 60606
(312) 726-9777

MARK A. WEISS
ROBERT A. LONG, JR.*
COVINGTON & BURLING
1201 Pennsylvania Avenue, N.W.
P.O. Box 7566
Washington, D.C. 20044
(202) 662-6000

Attorneys for Petitioner

August 31, 1995

* Counsel of Record

QUESTION PRESENTED

Whether the subject matter jurisdiction of federal courts under the civil liability provisions of the Expedited Funds Availability Act, 12 U.S.C. § 4010, is limited to disputes between depository institutions and persons other than such institutions, as the court of appeals held, or includes disputes between depository institutions.

**PARTIES TO THE PROCEEDING
AND RULE 29.1 STATEMENT**

Petitioner Bank One, Chicago, N.A. and Respondent Midwest Bank & Trust Company are the only parties to this proceeding. Petitioner formerly was known as First Illinois Bank & Trust.

Petitioner is a wholly-owned subsidiary of Banc One Illinois Corporation, an Illinois corporation. Banc One Illinois Corporation is a wholly-owned subsidiary of Banc One Corporation, an Ohio corporation.

TABLE OF CONTENTS

	Page
OPINIONS BELOW	1
JURISDICTION	2
STATUTORY AND REGULATORY PROVISIONS INVOLVED	2
STATEMENT	2
A. The Check Clearing Process, the Expedited Funds Availability Act, and Regulation CC	2
B. The Facts in this Case	6
C. The Decisions of the Courts Below	7
SUMMARY OF ARGUMENT	9
ARGUMENT	11
I. THE TEXT OF SECTION 4010 PROVIDES THAT FEDERAL COURTS HAVE JURISDICTION OVER INTERBANK DISPUTES UNDER THE EFA ACT AND REGULATION CC	11

II. THE LEGISLATIVE HISTORY SUPPORTS THE CONCLUSION THAT FEDERAL COURTS HAVE JURISDICTION OVER INTERBANK DISPUTES	15
III. THE COURT OF APPEALS' INTERPRETATION CONFLICTS WITH THIS COURT'S REASONING IN <i>COIT v. FSLIC</i>	17
IV. THE FEDERAL RESERVE BOARD'S CONCLUSION THAT IT LACKS AUTHORITY TO ADJUDICATE INTERBANK DISPUTES IS ENTITLED TO DEFERENCE	20
V. FEDERAL COURTS HAVE JURISDICTION UNDER 28 U.S.C. § 1331 TO DECIDE INTERBANK CLAIMS ARISING UNDER THE EFA ACT AND REGULATION CC . . .	21
VI. POLICY CONSIDERATIONS SUPPORT THE CONCLUSION THAT FEDERAL COURTS HAVE JURISDICTION OVER INTERBANK DISPUTES	22
CONCLUSION	24
APPENDIX	1a

TABLE OF AUTHORITIES

<i>Cases</i>	<i>Page</i>
<i>Alexander v. Hillman</i> , 296 U.S. 222 (1935)	22
<i>American Well Works Co. v. Layne & Bowler Co.</i> , 241 U.S. 257 (1916)	21
<i>Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.</i> , 467 U.S. 837 (1984)	10, 20
<i>Coit Independence Joint Venture v. FSLIC</i> , 489 U.S. 561 (1989)	10, 17, 18, 19
<i>Commodity Futures Trading Commission v. Schor</i> , 478 U.S. 833 (1986)	20, 22, 23
<i>Demarest v. Manspeaker</i> , 498 U.S. 184 (1991)	15
<i>Estate of Cowart v. Nicklos Drilling Co.</i> , 505 U.S. 469 (1992)	13, 15
<i>Gusafson v. Alloyd Co., Inc.</i> , 115 S. Ct. 1061 (1995)	13
<i>Heckler v. Chaney</i> , 470 U.S. 821 (1985)	19
<i>INS v. National Ctr. for Immigrants' Rights, Inc.</i> , 502 U.S. 183 (1991)	14
<i>K Mart Corp. v. Cartier, Inc.</i> , 486 U.S. 281 (1988)	20
<i>Melkonyan v. Sullivan</i> , 501 U.S. 89 (1991)	12
<i>Merrell Dow Pharmaceuticals v. Thompson</i> , 478 U.S. 804 (1986)	21
<i>Metropolitan Stevedore Co. v. Rambo</i> , 115 S. Ct. 2144 (1995)	11
<i>National R.R. Passenger Corp. v. Boston & Me. Corp.</i> , 503 U.S. 407 (1992)	20

<i>NationsBank of N.C. v. Variable Annuity</i>	
<i>Life Insurance Co.</i> , 115 S. Ct. 810 (1995)	20
<i>Reiter v. Cooper</i> , 113 S. Ct. 1213 (1993)	20
<i>Reno v. Koray</i> , 115 S. Ct. 2021 (1995)	12
<i>United Mine Workers v. Gibbs</i> , 383 U.S. 715 (1966)	22

Statutes, Legislative Materials, and Rules

Expedited Funds Availability Act,	
Title VI of the Competitive Equality	
Banking Act of 1987, Pub. L. No. 100-86, 101 Stat. 635	<i>passim</i>
Federal Credit Union Act, 12 U.S.C.	
§ 1751 <i>et seq.</i>	18
12 U.S.C. § 1464(d)	17
12 U.S.C. § 1464(d)(7)(A)	18
12 U.S.C. § 1729	17
12 U.S.C. § 1730	17
12 U.S.C. § 1730(j)(2)	18
12 U.S.C. § 1818	18, 19, 20
12 U.S.C. § 1818(b)	18
12 U.S.C. § 1818(b)(6)(A)	19
12 U.S.C. § 1818(h)	18
12 U.S.C. § 4001(17)	2
12 U.S.C. § 4001(20)	2
12 U.S.C. § 4002	4
12 U.S.C. § 4003	4
12 U.S.C. § 4004	4
12 U.S.C. § 4007	4
12 U.S.C. § 4008	4
12 U.S.C. § 4009	16, 18

12 U.S.C. § 4009(a)	4, 14, 23
12 U.S.C. § 4009(c)	4
12 U.S.C. § 4009(c)(1)	8, 17
12 U.S.C. § 4010	<i>passim</i>
12 U.S.C. § 4010(a)	12, 14
12 U.S.C. § 4010(a)(2)(A)	5
12 U.S.C. § 4010(c)	14
12 U.S.C. § 4010(d)	5, 9, 11, 14, 21
12 U.S.C. § 4010(f)	<i>passim</i>
28 U.S.C. § 1254(1)	2
28 U.S.C. § 1331	10, 21, 22
S. 790, 100th Cong., 1st Sess. § 609(a) (1987)	16
H.R. 28, 100th Cong., 1st Sess. § 14(a) (1987)	16
H.R. Conf. Rep. No. 261, 100th Cong., 1st Sess. 183 (1987)	15, 16
<i>The Role of the Federal Reserve in Check Clearing and the Nation's Payments System: Joint Hearings Before the House Comm. on Government Operations and the House Comm. on Banking, Finance & Urban Affairs</i> , 98th Cong., 1st Sess. (1983)	3
U.C.C. § 4-104(10)	3
U.C.C. § 4-105(2)	2
U.C.C. § 4-105(3)	2
U.C.C. § 4-105(4)	2
U.C.C. § 4-202	3
U.C.C. § 4-301	3
U.C.C. § 4-302	3
12 C.F.R. Pt. 229	5
12 C.F.R. § 229.2(e)	4
12 C.F.R. § 229.30	5
12 C.F.R. § 229.33(a)	5

12 C.F.R. § 229.33(b)(8)	5
12 C.F.R. § 229.38	5, 6, 8, 21, 22
12 C.F.R. § 229.38(a)	5, 7
12 C.F.R. § 229.38(g)	5, 20
50 Fed. Reg. 5,734 (1985)	3
Fed. R. Civ. P. 13(a)	22

Miscellaneous

Henry J. Bailey & Richard B. Hagedorn, <i>Brady on Bank Checks: The Law of Bank Checks</i> (7th ed. 1992 & Supp. 1995)	3
Black's Law Dictionary (6th ed. 1990)	12, 13
Barkley Clark & Barbara Clark, <i>The Law of Bank Deposits, Collections and Credit Cards</i> (rev. ed. 1995)	3
Robert D. Cooter & Edward L. Rubin, <i>Orders and Incentives as Regulatory Methods: The Expedited Funds Availability Act of 1987</i> , 35 UCLA L. Rev. 1115 (1988)	3
Dan B. Dobbs, <i>Law of Remedies</i> (2d ed. 1993)	19
Edward L. Rubin, <i>Uniformity, Regulation, and the Federalization of State Law: Some Lessons from the Payment System</i> , 49 Ohio St. L.J. 1251 (1989)	3
Webster's Third New International Dictionary (1993)	14
Charles Alan Wright, Arthur R. Miller & Edward H. Cooper, <i>Federal Practice and Procedure</i> (2d ed. 1984 & 1995 Supp.)	21

*In The***Supreme Court of the United States****OCTOBER TERM, 1995****No. 94-1175****BANK ONE, CHICAGO, N.A.,***Petitioner,*

v.

MIDWEST BANK & TRUST COMPANY,*Respondent.*

**ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT**

BRIEF FOR THE PETITIONER**OPINIONS BELOW**

The amended opinion of the court of appeals (J.A. 7-9) is reported at 30 F.3d 64. The opinions of the district court (Pet. App. 5a-14a, 17a-22a) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on July 11, 1994. A petition for rehearing was denied on September 20, 1994. Pet. App. 24a-25a. The petition for a writ of certiorari was filed on December 19, 1994, and granted on June 26, 1995. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Sections 4009 and 4010 of Title 12, United States Code, and sections 229.30 and 229.38 of Title 12, Code of Federal Regulations, are reprinted at App., *infra*, 1a-11a.

STATEMENT

A. The Check Clearing Process, the Expedited Funds Availability Act, and Regulation CC

1. When a customer deposits a check, the customer's bank sends the check to the bank on which the check is drawn for payment. The bank at which the check is deposited is referred to as the "depositary" or "receiving" bank; the bank on which the check is drawn is referred to as the "payor" or "originating" bank. See 12 U.S.C. § 4001(17), (20); U.C.C. § 4-105(2), (3). Because thousands of banks in the United States process billions of checks each year, it is not feasible for each depositary bank to deal directly with each payor bank. Instead, the depositary bank is likely to forward the check through other banks (referred to as "intermediary banks," U.C.C. § 4-105(4)), the check processing facilities of the Federal Reserve System, or a private check clearing house association. When the check is presented to the payor bank,

that bank either pays the check or "dishonors" it by returning the check unpaid to the depositary bank.¹

Prior to the enactment of the Expedited Funds Availability Act, the check collection process was governed largely by state law, in particular Articles 3 and 4 of the Uniform Commercial Code. The U.C.C. imposes a "midnight deadline," under which a bank has until midnight on the banking day after it receives a check to send the check to the next bank in the process. See U.C.C. §§ 4-104(10), 4-202, 4-301, 4-302. Despite the midnight deadline, the check-clearing process often took days or weeks to complete. As a result, depositary banks often placed lengthy "holds" on deposited funds to protect themselves in the event the payor bank dishonored the check.²

¹ The check clearing process is described in Robert D. Cooter & Edward L. Rubin, *Orders and Incentives as Regulatory Methods: The Expedited Funds Availability Act of 1987*, 35 UCLA L. Rev. 1115, 1121-1122 (1988), and Edward L. Rubin, *Uniformity, Regulation, and the Federalization of State Law: Some Lessons from the Payment System*, 49 Ohio St. L.J. 1251, 1253-56 (1989). See generally Henry J. Bailey & Richard B. Hagedorn, *Brady on Bank Checks: The Law of Bank Checks* (7th ed. 1992 & Supp. 1995); Barkley Clark & Barbara Clark, *The Law of Bank Deposits, Collections and Credit Cards* (rev. ed. 1995); *The Role of the Federal Reserve in Check Clearing and the Nation's Payments System: Joint Hearings Before the House Comm. on Government Operations and the House Comm. on Banking, Finance & Urban Affairs*, 98th Cong., 1st Sess. (1983).

² The Federal Reserve Board attempted to speed up the check-clearing process by amending one of its regulations, known as Regulation J, to require the payor bank to notify the depositary bank that it was dishonoring a check by the second banking day following the day on which the payor bank was required to dishonor the check. The amendments to Regulation J applied only to checks for more than \$2,500 that were processed by a Federal Reserve Bank. See 50 Fed. Reg. 5,734 (1985); Cooter & Rubin, 35 UCLA L. Rev. 1139.

2. Congress responded to complaints that banks were placing excessively long holds on deposited funds by enacting the Expedited Funds Availability Act ("EFA Act" or "Act") as Title VI of the Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, 101 Stat. 635 (codified at 12 U.S.C. §§ 4001-4010). To expedite the availability of deposited funds, the EFA Act establishes funds availability schedules requiring that certain deposits be made available to depositors on the next business day, and requiring that other deposits be made available within specified time periods, subject to certain exceptions. 12 U.S.C. §§ 4002, 4003. The Act also requires banks to disclose their funds availability policy to customers. *Id.* § 4004. To reduce banks' risk of non-payment, the EFA Act authorizes the Board of Governors of the Federal Reserve System ("Federal Reserve Board" or "Board") to consider improvements to the check-processing system and issue regulations implementing such improvements. *Id.* § 4008. The Act expressly provides that the Board's regulations preempt inconsistent state laws, except certain state laws that impose even shorter funds availability deadlines. *Id.* § 4007.

Five different federal agencies are directed to enforce compliance with the Act and its regulations by exercising their existing authority to regulate different categories of depository institutions. 12 U.S.C. § 4009(a). In addition, the Federal Reserve Board is authorized to enforce the Act to the extent that enforcement is not specifically committed to some other agency. *Id.* § 4009(c).³

³ The EFA Act applies to "depository institutions," and Regulation CC defines "bank" broadly to include participants in the payment system, such as thrift institutions and credit unions. See 12 C.F.R. § 229.2(e). For simplicity, this brief generally uses "bank" as a general term for all depository institutions covered by the EFA Act.

Congress provided for civil liability under 12 U.S.C. § 4010. The liability of banks to any person other than a bank is governed by subsection (a); liability among banks is governed by subsection (f). Banks may be held liable to nonbanks for actual damages, plus attorney's fees, costs, and an "additional amount" between \$100 and \$1,000 (for nonclass action suits). *Id.* § 4010(a)(2)(A). Liability among banks is to be governed by rules promulgated by the Federal Reserve Board, but such liability may not exceed the amount of the check and, in cases of bad faith only, other damages proximately caused by the violation. *Id.* § 4010(f). Congress provided that "[a]ny action under this section" may be brought in federal district court or in any other court of competent jurisdiction. *Id.* § 4010(d).

3. The Board has implemented the EFA Act through Regulation CC, 12 C.F.R. Pt. 229. Subpart C of Regulation CC promulgates rules to expedite the collection and return of checks. In particular, Subpart C imposes a "requirement of expeditious return" on payor banks, 12 C.F.R. § 229.30 (1995); requires payor banks to give depositary banks prompt notice of nonpayment, *id.* § 229.33(a); and specifies that a notice of nonpayment must include the reason for nonpayment, as well as other information, *id.* § 229.33(b)(8).

Section 4010(f) of the statute is implemented by 12 C.F.R. § 229.38, which contains rules governing interbank liability. The rules require banks to "exercise ordinary care and act in good faith in complying with the requirements of [Subpart C]" and provide that banks failing to exercise such care may be held liable to other parties to the check for "the amount of the loss incurred, up to the amount of the check, reduced by the amount of the loss that party would have incurred even if the bank had exercised ordinary care." 12 C.F.R. § 229.38(a). The jurisdictional language in section 4010(d) of the statute is duplicated in 12 C.F.R. § 229.38(g).

B. The Facts in this Case

Petitioner and respondent are banks that use the Federal Reserve Bank of Chicago as a clearing house for collection of checks. On September 25, 1991, one of petitioner's commercial customers deposited to its account with petitioner a check drawn on respondent for \$64,294.27. In accordance with its published funds availability policy, petitioner made the deposited funds available to its customer for withdrawal on September 26, one business after the deposit. Pet. App. 6a.

Petitioner forwarded the check for collection through the Federal Reserve System. Respondent received the check on September 26. Respondent returned the check unpaid, stating that the return was for "guarantee of endorsement." Respondent did not determine whether there were sufficient funds in its customer's account to pay the check. On September 26, respondent's customer's account had a balance of \$275.31. Pet. App. 6a-7a.

Petitioner received the returned check on Friday, September 27. That same day, petitioner affixed its guarantee of endorsement stamp and resubmitted the check for clearance through the Federal Reserve System. Pet. App. 7a.

Respondent received the resubmitted check on Monday, September 30. On October 1, respondent again refused to pay the check. This time, respondent stated that there were insufficient funds in its customer's account to pay the check. Pet. App. 7a-8a.

By the time petitioner received notice from respondent that there were insufficient funds to pay the check, petitioner's customer had withdrawn \$43,916.06 from its account with petitioner, which has not been repaid. Pet. App. 8a. If respondent's first notice of nonpayment had stated that there

were insufficient funds in the account, petitioner would not have suffered any loss. Pet. App. 8a, 13a-14a.

C. The Decisions of the Courts Below

1. Petitioner filed a complaint in district court alleging that respondent had breached its obligations under several provisions of Regulation CC.⁴ The district court (N.D. Ill., Kocoras, J.) denied respondent's motion to dismiss the action, and subsequently granted petitioner's motion for summary judgment. Pet. App. 5a-22a.

The district court held that respondent had breached its duty to petitioner under 12 C.F.R. § 229.38(a) by failing to "act according to reasonable banking standards." Pet. App. 10a. The court found that respondent "allowed a check to be returned for the reason that it was missing an endorsement without the bank first knowing that it was NSF [not sufficient funds]," and that this policy "was not utilized by any other bank." Pet. App. 10a. The court further found that, "[b]ecause all other banks would have informed [petitioner] that the . . . check was NSF if that were the case, [petitioner] acted in a reasonably foreseeable manner in assuming that upon receipt of the check the drawer had sufficient funds on account at [respondent] to pay." Pet. App. 11a. The court rejected as "untenable" the position "that the reasons for dishonor can be investigated one at a time and the check

⁴ Petitioner initially filed a complaint in state court alleging that respondent had breached its duties to petitioner under Regulation CC and Illinois law. *First Illinois Bank & Trust v. Midwest Bank & Trust Co.*, No. 92L02538 (Cir. Ct. Cook County, Ill. filed Feb. 28, 1992). The state trial court granted respondent's motion to strike the complaint for failure to satisfy the pleading requirements of Illinois law. Order of July 20, 1992. Rather than filing an amended complaint in state court, petitioner elected to bring an action in district court.

returned in successive stages over a substantial period of time, particularly when the means to determine insufficiency of funds, an important reason for dishonor, is readily available." Pet. App. 12a.

2. The court of appeals (*Cummings*, Easterbrook, and Manion, JJ.) vacated the judgment and remanded the case to the district court with instructions to dismiss for want of jurisdiction. J.A. 7-9. The court of appeals raised the jurisdictional issue *sua sponte* and held that federal courts lack jurisdiction to decide interbank disputes under the EFA Act. The court of appeals recognized that "[s]ubsection (d) [of section 4010] ("Jurisdiction") provides that 'any action under this section [i.e., section 4010] may be brought in any United States district court. . . ." J.A. 8. But the court concluded that subsection (a) "limits the application of the section to certain disputes between 'any depository institution' and 'any person other than another depository institution.'" J.A. 8. Because petitioner and respondent both are "depository institutions" within the meaning of the EFA Act, the court of appeals held that the federal courts lack subject matter jurisdiction in this case. J.A. 8.

The court of appeals concluded that "[d]isputes such as this, between members of the Federal Reserve System, are to be handled administratively before the Board of Governors of the Federal Reserve System pursuant to 12 U.S.C. § 4009(c)(1)." J.A. 9. In support of this conclusion, the court of appeals cited 12 U.S.C. § 4010(f), which "authorize[s] the Federal Reserve Board to establish liability among 'depository institutions' such as these parties." J.A. 9. The court of appeals concluded that "depositors have rights, enforceable in court, while the banks have obligations, which the Federal Reserve Board may establish by regulation and enforce in administrative proceedings." J.A. 9.

3. Petitioner filed a petition for rehearing and suggestion of rehearing *en banc*, and the Board of Governors of the Federal Reserve System filed a brief *amicus curiae* in support of the petition. The court of appeals denied the petition, but amended its opinion in two respects. First, it added a parenthetical phrase to note that interbank disputes are to be handled administratively "or perhaps in state court." Pet. App. 25a; J.A. 9. Second, the court of appeals deleted a sentence from its opinion stating that petitioner "must make its case before the Board of Governors rather than the federal courts." Pet. App. 2a. In place of the omitted sentence, the court of appeals added the following sentence: "Although the Board of Governors has informed us that no mechanism is currently available for administrative resolution of such disputes, the Board's differing interpretation of this statute cannot confer jurisdiction upon the Court." Pet. App. 25a; J.A. 9.

SUMMARY OF ARGUMENT

1. The text of 12 U.S.C. § 4010 answers the question presented in this case. Subsection (d) provides that "[a]ny action under this section may be brought in any United States district court." Subsection (f), by providing for interbank "liability" up to the amount of the check, as well as "other damages" in certain cases, authorizes interbank actions for violations of liability rules promulgated by the Federal Reserve Board. The ordinary meaning of "damages" is compensation recovered in a court. Moreover, Congress used the identical term "liability" in subsection (a) to refer to liability for damages in a judicial action. Subsection (f) authorizes the Federal Reserve Board to allocate "the risks of loss and liability," not actual losses. Thus, Congress authorized the Board to promulgate liability rules, but did not authorize administrative adjudication of interbank claims for damages.

2. The language of the Conference Report indicates that Congress contemplated actions under subsection (f). In addition, the legislative history confirms that Congress did not intend to authorize the creation of a new administrative enforcement mechanism to adjudicate interbank claims under the EFA Act. *Id.*

3. The court of appeals' decision conflicts with the reasoning of this Court's decision in *Coit Independence Joint Venture v. FSLIC*, 489 U.S. 561 (1989), which held that a federal regulatory agency lacked authority to adjudicate state law claims. Here, as in *Coit*, Congress legislated against the background of a complex statutory framework in which it has set forth detailed administrative procedures and expressly provided for judicial review. As in *Coit*, Congress did not expressly confer on the agency authority to adjudicate claims, and did not specify procedures or provide for judicial review of such adjudications.

4. The Federal Reserve Board has interpreted section 4010(f) to authorize interbank actions, and has concluded that it lacks authority to adjudicate interbank disputes. That interpretation does not conflict with the plain language of the statute, and therefore qualifies for deference under the doctrine of *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842 (1984).

5. Federal district courts also have general federal-question jurisdiction under 28 U.S.C. § 1331 to decide interbank claims arising under section 4010 and its implementing regulations. Subsection (f) plainly creates a federal cause of action for violations of interbank liability rules promulgated by the Federal Reserve Board in Regulation CC.

6. Under the Federal Reserve Board's interpretation, federal and state courts have concurrent jurisdiction to decide all check-related claims arising out of a single set of facts. In contrast, the court of appeals' interpretation fragments jurisdiction by assigning interbank claims to an administrative tribunal and other check-related claims to the courts. The court of appeals' interpretation also creates inter-agency jurisdictional problems among the five federal agencies that share responsibility for enforcing the EFA Act.

ARGUMENT

I. THE TEXT OF SECTION 4010 PROVIDES THAT FEDERAL COURTS HAVE JURISDICTION OVER INTERBANK DISPUTES UNDER THE EFA ACT AND REGULATION CC.

In a statutory construction case, analysis begins with the language of the statute. *Metropolitan Stevedore Co. v. Rambo*, 115 S. Ct. 2144, 2147 (1995). The text of 12 U.S.C. § 4010 answers the question presented in this case. Subsection (d) of section 4010 provides:

(d) Jurisdiction

Any action under this section may be brought in any United States district court, or in any other court of competent jurisdiction, within one year after the date of the occurrence of the violation involved.

The language of subsection (d) could not be clearer: *Any* action under section 4010 may be brought in a United States district court. If section 4010 authorizes interbank actions for violations of the EFA Act or regulations promulgated under

the Act, then federal district courts plainly have jurisdiction to decide such actions.⁵

The court of appeals focused on subsection (a) of section 4010, which provides that depository institutions are liable to "any person other than another depository institution" for "fail[ure] to comply with any requirement imposed under [the EFA Act] or any regulation prescribed under [the Act]." The court of appeals concluded that, because a bank cannot bring an action against another bank under subsection (a), it cannot do so under section 4010. J.A. 8. The jurisdiction-conferring language of subsection (d) is not confined to actions under subsection (a); instead, subsection (d) provides that "any action under this *section*" may be brought in district court. (Emphasis added.) A different subsection of section 4010 — subsection (f) — authorizes interbank actions.

Section 4010(f) provides:

(f) Authority to establish rules regarding losses and liability among depository institutions

The Board is authorized to impose on or allocate among depository institutions the risks of loss and liability in connection with any aspect of the payment system, including the receipt, payment, collection or clearing of checks, and any related function of the payment system with respect to checks. Liability under this subsection shall not exceed the amount of

the check giving rise to the loss or liability, and, where there is bad faith, other damages, if any, suffered as a proximate consequence of any act or omission giving rise to the loss or liability.

Subsection (f) speaks the language of actions in a court of law. First, it authorizes liability for "damages." The ordinary meaning of "damages" is "a pecuniary compensation or indemnity, which may be recovered *in the courts* by any person who has suffered loss, detriment, or injury, . . . through the unlawful act or omission or negligence of another." Black's Law Dictionary 389 (6th ed. 1990) (emphasis added). Second, subsection (f) provides for "liability under this subsection." The term "liability," when used in conjunction with "damages," refers to "[l]iability for an amount to be ascertained by trial of the facts in particular cases." Black's Law Dictionary 914. Indeed, Congress used the identical term "liability" in subsection (a) to refer to the obligation to pay damages imposed by a court of law. It is a "basic canon of statutory construction that identical terms within an Act bear the same meaning." *Estate of Cowart v. Nicklos Drilling Co.*, 112 S. Ct. 2589, 2596 (1992); see also *Gustafson v. Alloyd Co., Inc.*, 115 S. Ct. 1061, 1067 (1995). Third, subsection (f) employs the concepts of bad faith and proximate causation, both of which are staples of private judicial actions.

The language of subsection (f) does not confer on the Federal Reserve Board authority to adjudicate interbank claims for damages. The Board is authorized to "impose on or allocate among depository institutions the *risks* of loss and liability." 12 U.S.C. § 4010(f) (emphasis added). The word "risk" is forward-looking; it means a "possibility of loss." *Webster's Third New International Dictionary* 1961 (1993). In authorizing the Board to allocate "the risks of loss and liability," Congress could not have contemplated that the

⁵ "[I]n its usual legal sense," an "action" is "a lawsuit brought in a court." Black's Law Dictionary 28 (6th ed. 1990). See *Melkonyan v. Sullivan*, 501 U.S. 89, 94-95 (1991) ("action" refers to proceedings in a court); see generally *Reno v. Koray*, 115 S. Ct. 2021, 2025 (1995) ("meaning of a word . . . must be drawn from the context in which it is used").

Board would be engaging in adjudication, because adjudication allocates actual losses, not possible losses. Instead of adjudication, the text of section 4010(f) indicates that Congress contemplated rulemaking, which is prospective in nature and therefore would allow the Board to allocate the risks of losses and liabilities yet to be incurred. This conclusion is confirmed by the title of subsection (f), which describes subsection (f) as conferring "[a]uthority to establish rules regarding losses and liability among depository institutions." (Emphasis added.) See *INS v. National Ctr. for Immigrants' Rights, Inc.*, 502 U.S. 183, 189 (1991) (proper to consider title of a statute or section to resolve any ambiguity in the statutory text).

The statutory structure provides additional support for the conclusion that section 4010 authorizes interbank actions for violations of the Act and Regulation CC. First, subsections (a) and (f) of section 4010 parallel and complement each other in important respects. Both subsections create liability for damages and place limits on the amount of damages that may be recovered. Subsection (a) governs the liability of a depository institution to "any person other than another depository institution." Subsection (f) governs liability among depository institutions, and places stricter limitations on damages in cases of interbank liability.⁶ Together, Subsections (a) and (f) provide for liability for damages for all violations of the Act and its regulations. In addition, subsections (c) and (d) refer to "any action brought under this

⁶ Compare 12 U.S.C. § 4010(a) (providing for actual damages, attorney's fees, costs, and additional damages of between \$100 and \$1,000 in individual actions, and up to \$500,000 or 1% of the net worth of the bank in class actions) with 12 U.S.C. § 4010(f) (providing that liability generally "shall not exceed the amount of the check," and even in cases of bad faith shall not exceed actual damages proximately caused by the violation).

section." If Congress had intended to authorize actions only under subsection (a), it would have been much clearer to refer to actions brought under subsection (a).

In sum, the statutory text leaves no doubt that a bank may bring an action against another bank for a violation of the EFA Act or Regulation CC, and that such an action may be brought in a federal court.

II. THE LEGISLATIVE HISTORY SUPPORTS THE CONCLUSION THAT FEDERAL COURTS HAVE JURISDICTION OVER INTERBANK DISPUTES.

"[W]hen a statute speaks with clarity to an issue, judicial inquiry into the statute's meaning, in all but the most extraordinary circumstances, is finished." *Estate of Cowart v. Nicklos Drilling Co.*, 505 U.S. 469, 475 (1992); see also *Demarest v. Manspeaker*, 498 U.S. 184, 190 (1991). The text of Section 4010 provides a clear answer to the question in this case, and therefore the Court need not consider the legislative history of the EFA Act. In any event, the legislative history reinforces the meaning of the statutory text.

Subsection (f) was added to section 4010 by the Conference Committee. The Conference Report states that subsection (f) "does not limit causes of action brought by accountholders or the amount of damages recoverable by accountholders under any other action." H.R. Conf. Rep. No. 261, 100th Cong., 1st Sess. 183 (1987) (emphasis added). This statement indicates that the conferees regarded a proceeding under subsection (f) as an "action."

As initially passed by the House and Senate, the language of subsection (a) was broad enough to authorize interbank actions. The House version of subsection (a) provided:

Except as otherwise provided in this section, any depository institution which fails to comply with any requirement imposed under this Act or any regulation prescribed under this Act with respect to *any person* is liable to such person

H.R. 28, 100th Cong., 1st Sess. § 14(a) (1987) (emphasis added). Similarly, the Senate version of subsection (a) provided:

Except as otherwise provided in this section, any depository institution which fails to comply with any requirement imposed under section 603, 604, 605, 606, or 607 with respect to *any person* is liable to such person

S. 790, 100th Cong., 1st Sess. § 609(a) (1987) (emphasis added). When the Conference Committee modified subsection (a) to exclude interbank actions and added a new subsection (f), it gave no indication that it intended interbank liability to be adjudicated in a different forum. Instead, subsection (f) imposes different limitations on damages in interbank disputes, and authorizes the Federal Reserve Board to establish interbank liability rules. If Congress had intended to do more than this — for example, to move interbank disputes from courts to a new (and hitherto nonexistent) administrative tribunal — it almost certainly would have given some indication of such an intent.

Finally, the Conference Report states that § 4009 "requires the Federal banking regulators to use *existing* administrative enforcement mechanisms to enforce compliance with" the EFA Act. H.R. Conf. Rep. No. 261, at 183 (emphasis added). As explained below, see *infra* pp. 18-19, existing administrative enforcement mechanisms do not include a mechanism for adjudicating interbank claims for

damages. Consequently, the court of appeals erred in concluding that interbank disputes "are to be handled administratively before the Board of Governors of the Federal Reserve System pursuant to 12 U.S.C. § 4009(c)(1)" J.A. 9.

III. THE COURT OF APPEALS' INTERPRETATION CONFLICTS WITH THIS COURT'S REASONING IN *COIT v. FSLIC*.

The court of appeals concluded that the Federal Reserve Board has authority to adjudicate interbank claims for damages arising under the EFA Act and Regulation CC. J.A. 9. That conclusion conflicts with the reasoning of this Court's decision in *Coit Independence Joint Venture v. FSLIC*, 489 U.S. 561 (1989). In *Coit*, the Court held that the Federal Savings and Loan Insurance Corporation lacked authority to adjudicate state law claims asserted against insolvent thrift institutions. In reaching that conclusion, the Court relied on the absence of a clear statement by Congress that it intended to authorize an administrative agency to adjudicate private claims:

The statutory framework in which [12 U.S.C.] § 1729 appears indicates clearly that when Congress meant to confer adjudicatory authority on FSLIC it did so explicitly and set forth the relevant procedures in considerable detail. For example, in its role as supervisor of ongoing thrift institutions, FSLIC together with the Bank Board is empowered to adjudicate violations of federal law, to issue cease-and-desist orders, to remove officers and directors, and to impose civil sanctions. See 12 U.S.C. §§ 1464(d), 1730. The statutory provisions that confer this authority set forth with precision the agency procedures to be followed and the remedies available, with explicit reference to judicial review

under the Administrative Procedure Act. See 12 U.S.C. §§ 1464(d)(7)(A), 1730(j)(2). It is thus reasonable to infer that if Congress intended to confer adjudicatory authority upon FSLIC in its receivership capacity, it would have enacted similar provisions governing procedural and substantive rights and providing for judicial review.

Coit, 489 U.S. at 573-74.

The Court's reasoning in *Coit* is fully applicable to this case. Here, as in *Coit*, the statutory provision at issue does not explicitly confer adjudicatory authority on the agency, does not specify any procedures for administrative adjudications (let alone specify such procedures "in considerable detail," 489 U.S. at 574), and does not mention judicial review of administrative adjudications. As in *Coit*, the statutory context demonstrates that when Congress meant to confer adjudicatory authority on the agency it did so explicitly. Section 4009 provides that compliance shall be enforced under section 8 of the Federal Deposit Insurance Act, 12 U.S.C. § 1818 (for most depository institutions), or the Federal Credit Union Act, 12 U.S.C. § 1751 *et seq.* (for certain credit unions). Section 1818 of Title 12 sets forth agency procedures and remedies with a level of precision comparable to that of the regulatory provisions considered by the Court in *Coit*. See, e.g., 12 U.S.C. § 1818(b) (notice and hearing requirements); 12 U.S.C. § 1818(h) (providing for judicial review under the APA).

Although the FSLIC had enforcement authority similar to that of the Federal Reserve Board under Section 4009, this Court in *Coit* did not regard that authority as extending to adjudication of private claims. See 489 U.S. at 574. The same is true here. The enforcement provisions of the EFA Act authorize banking agencies to use traditional enforcement

mechanisms such as cease-and-desist orders; they do not authorize administrative adjudication of private claims for damages. The closest 12 U.S.C. § 1818 comes to authorizing an administrative award of "damages" is a provision authorizing the agency to require "restitution," "reimbursement," or "indemnification" in cases involving unjust enrichment or reckless disregard for the law. 12 U.S.C. § 1818(b)(6)(A). Subsection 4010(f) does not require a showing of unjust enrichment or reckless disregard for the law as a prerequisite for recovering damages, and restitution and damages are different remedies. See 1 Dan B. Dobbs, *Law of Remedies* § 1.1, at 5 (2d ed. 1993) ("restitution is measured by the defendant's gains, not by the plaintiff's losses").

In addition, enforcement proceedings under 12 U.S.C. § 1818 are initiated by the agency, not by private parties. Although a bank can ask the agency to take enforcement action, the decision whether to initiate such an enforcement action is within the agency's discretion, and is not subject to judicial review. See *Heckler v. Chaney*, 470 U.S. 821, 831 (1985). Consequently, a bank's ability to recover damages under the court of appeals' interpretation of section 4010(f) often would depend on a variety of factors unrelated to the merits of its claim, including the resources available to the agency and its enforcement priorities. Thus, the court of appeals' decision would not merely change the forum in which interbank claims would be adjudicated; it would deprive banks of the ability to pursue such claims altogether as a matter of right, permitting them to proceed only at the discretion of the regulatory agency.

IV. THE FEDERAL RESERVE BOARD'S CONCLUSION THAT IT LACKS AUTHORITY TO ADJUDICATE INTERBANK DISPUTES IS ENTITLED TO DEFERENCE.

When the intent of Congress is clear, that is "the end of the matter." *NationsBank of N.C. v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810, 813 (1995), quoting *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842 (1984). Even if Section 4010 were ambiguous, however, the Federal Board's interpretation of the statute would be entitled to deference. See *National R.R. Passenger Corp. v. Boston & Me. Corp.*, 503 U.S. 407, 417 (1992) (court will defer to agency's construction, so long as that interpretation does not conflict with the plain language of the statute; *K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 292 (1988) (same).

The Federal Reserve Board, the agency responsible for implementing the EFA Act, has construed section 4010 not to confer on the Board any authority to adjudicate interbank claims under the EFA Act or Regulation CC. See 12 C.F.R. § 229.38(g). That interpretation does not conflict with the plain language of the statute; indeed, it is strongly supported by the statutory text. Accordingly, the Board's interpretation of section 4010 is entitled to judicial deference under the *Chevron* doctrine. See *Reiter v. Cooper*, 113 S. Ct. 1213, 1221 (1993) (agency's view that it had no initial jurisdiction with respect to an award of reparations was "a reasonable interpretation of the statute, and hence a binding one"); *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833, 844-46 (1986) (agency's interpretation of federal statute as conferring jurisdiction on the agency to adjudicate state law counterclaims was entitled to deference).

V. FEDERAL COURTS HAVE JURISDICTION UNDER 28 U.S.C. § 1331 TO DECIDE INTERBANK CLAIMS ARISING UNDER THE EFA ACT AND REGULATION CC.

Apart from the specific statutory grant of jurisdiction in 12 U.S.C. § 4010(d), federal courts have general federal-question jurisdiction under 28 U.S.C. § 1331 to decide interbank claims arising under Section 4010 and Regulation CC.

Section 1331 provides that "[t]he district courts shall have original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States." It is well settled that an action "arises under" federal law for purposes of section 1331 if "federal law creates the cause of action." *Merrell Dow Pharmaceuticals v. Thompson*, 478 U.S. 804, 808 (1986). See *American Well Works Co. v. Layne & Bowler Co.*, 241 U.S. 257, 260 (1916). In some circumstances, moreover, an action may arise under federal law even though state law provides the cause of action. See *Merrell Dow*, 478 U.S. at 808-810. In this case, the Court need not address the sometimes difficult questions posed by "the presence of a federal issue in a state-created cause of action," *Merrell Dow*, 478 U.S. at 810, because subsection (f) and its implementing regulations plainly create a federal cause of action.

An action "arises under" federal law for purposes of section 1331 if it arises under "an Act of Congress or an administrative regulation or executive order made pursuant to an Act of Congress." 13B Charles Alan Wright, Arthur R. Miller & Edward H. Cooper, *Federal Practice and Procedure* § 3563, at 51 (2d ed. 1984 & 1995 Supp.) (citing authorities). Subsection (f) creates an interbank cause of action by providing for "[l]iability under this subsection" in "the amount of the check giving rise to the loss or liability," as well as

"other damages" in certain cases. 12 U.S.C. § 4010(f). Pursuant to subsection (f), the Federal Reserve Board has promulgated regulations establishing interbank liability rules and providing that a bank may bring an action for damages against other banks that violate the rules. See 12 C.F.R. § 229.38. Accordingly, interbank actions under subsection 4010(f) and Regulation CC arise under federal law, and 28 U.S.C. § 1331 provides an additional basis for federal jurisdiction.

VI. POLICY CONSIDERATIONS SUPPORT THE CONCLUSION THAT FEDERAL COURTS HAVE JURISDICTION OVER INTERBANK DISPUTES.

Federal policy generally favors adjudication of an entire controversy in a single forum. See, e.g., *CFTC v. Schor*, 478 U.S. at 843-44 (bifurcation of claims between commodities brokers and their customers would preclude efficient remedies); *Alexander v. Hillman*, 296 U.S. 222, 241-43 (1935) (district courts in receivership actions may determine counterclaims in order to provide "complete relief"); Fed. R. Civ. P. 13(a) (requiring the assertion of counterclaims arising out of the "transaction or occurrence that is the subject matter of the opposing party's claim"). Under the Federal Reserve Board's interpretation of section 4010, federal courts and state courts have concurrent jurisdiction to decide all check-related claims arising out of a single transaction. Federal courts have jurisdiction to decide state-law claims arising out of a "common nucleus of operative fact," even in non-diversity cases, under the doctrine of pendent jurisdiction. See *United Mine Workers v. Gibbs*, 383 U.S. 715, 725 (1966).

In contrast, the court of appeals' interpretation of section 4010 fragments jurisdiction to decide check-related claims. The court of appeals' interpretation makes it impossible to

resolve depositor claims and interbank claims in a single proceeding, even though both types of claims may arise out of a single set of facts. In addition, the court of appeals' interpretation may well require interbank claims under state law to be filed in a state court, while interbank claims under federal law must be decided by a federal agency.⁷ Thus, the court of appeals' decision is likely to result in inefficient piecemeal litigation of check-related claims.

Finally, the court of appeals' interpretation gives rise to inter-agency jurisdictional questions. The EFA Act confers enforcement authority on five different federal agencies.⁸ If a depository institution regulated by one agency asserted a claim against an institution regulated by a different agency, it is unclear which agency would have authority to adjudicate the claim. Congress is unlikely to have intended to create such a jurisdictional muddle.

⁷ The Court has recognized that "wholesale importation of concepts of pendent or ancillary jurisdiction into the agency context" would raise "constitutional difficulties." *CFTC v. Schor*, 478 U.S. at 852.

⁸ See 12 U.S.C. § 4009(a) (conferring authority to enforce EFA Act on the Comptroller of the Currency (as to national banks), the Federal Reserve Board (as to member banks of the Federal Reserve System other than national banks); the Federal Deposit Insurance Corporation (as to banks insured by the FDIC other than members of the Federal Reserve System), the Director of the Office of Thrift Supervision (for savings associations insured by the FDIC), and the National Credit Union Administration Board (for federal credit unions and insured credit unions)).

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted,

JEFFREY S. BLUMENTHAL
KAMM & SHAPIRO, LTD.
Suite 1100
230 West Monroe Street
Chicago, Illinois 60606
(312) 726-9777

MARK A. WEISS
ROBERT A. LONG, JR.*
COVINGTON & BURLING
1201 Pennsylvania Ave., N.W.
P.O. Box 7566
Washington, D.C. 20044
(202) 662-6000

Attorneys for Petitioner

* Counsel of Record

August 31, 1995

APPENDIX

1. Section 4009 of Title 12, United States Code, provides:

§ 4009. Administrative enforcement**(a) Administrative enforcement**

Compliance with the requirements imposed under this chapter, including regulations prescribed by and orders issued by the Board of Governors of the Federal Reserve System under this chapter, shall be enforced under—

- (1) section 8 of the Federal Deposit Insurance Act [12 U.S.C.A. § 1818] in the case of—
 - (A) national banks, by the Comptroller of the Currency;
 - (B) member banks of the Federal Reserve System (other than national banks), by the Board of Governors of the Federal Reserve System; and
 - (C) banks insured by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System), by the Board of Directors of the Federal Deposit Insurance Corporation;
- (2) section 8 of the Federal Deposit Insurance Act [12 U.S.C.A. § 1818], by the Director of the Office of Thrift Supervision in the case of savings associations the deposits of which are insured by the Federal Deposit Insurance Corporation; and
- (3) the Federal Credit Union Act [12 U.S.C.A. § 1751 *et seq.*], by the National Credit Union Administration Board with respect to any Federal credit union or insured credit union.

(1a)

(b) Additional powers

(1) Violation of this chapter treated as violation of other Acts

For purposes of the exercise by any agency referred to in subsection (a) of this section of its powers under any Act referred to in that subsection, a violation of any requirement imposed under this chapter shall be deemed to be a violation of a requirement imposed under that Act.

(2) Enforcement authority under other Acts

In addition to its powers under any provision of law specifically referred to in subsection (a) of this section, each of the agencies referred to in such subsection may exercise, for purposes of enforcing compliance with any requirement imposed under this chapter, any other authority conferred on it by law.

(c) Enforcement by Board

(1) In general

Except to the extent that enforcement of the requirements imposed under this chapter is specifically committed to some other Government agency under subsection (a) of this section, the Board of Governors of the Federal Reserve System shall enforce such requirements.

(2) Additional remedy

If the Board determines that

(A) any depository institution which is not a depository institution described in subsection (a) of this section, or

(B) any other person subject to the authority of the Board under this chapter including any person subject to the authority of the Board under section 4004(d)(2) or 4008(c) of this title,

has failed to comply with any requirement imposed by this chapter or by the Board under

this chapter, the Board may issue an order prohibiting any depository institution, any Federal Reserve bank, or any other person subject to the authority of the Board from engaging in any activity or transaction which directly or indirectly involves such noncomplying depository institution or person (including any activity or transaction involving the receipt, payment, collection, and clearing of checks and any related function of the payment system with respect to checks).

(d) Procedural rules

The authority of the Board to prescribe regulations under this chapter does not impair the authority of any other agency designated in this section to make rules regarding its own procedures in enforcing compliance with requirements imposed under this chapter.

2. Section 4010 of Title 12, United States Code, provides:

§ 4010. Civil liability

(a) Civil liability

Except as otherwise provided in this section, any depository institution which fails to comply with any requirement imposed under this chapter or any regulation prescribed under this chapter with respect to any person other than another depository institution is liable to such person in an amount equal to the sum of—

(1) any actual damage sustained by such person as a result of the failure;

(2)(A) in the case of an individual action, such additional amount as the court may allow, except that the liability under this subparagraph shall not be less than \$100 nor greater than \$1,000; or

(B) in the case of a class action, such amount as the court may allow, except that—

(i) as to each member of the class, no minimum recovery shall be applicable; and

(ii) the total recovery under this subparagraph in any class action or series of class actions arising out of the same failure to comply by the same depository institution shall not be more than the lesser of \$500,000 or 1 percent of the net worth of the depository institution involved; and

(3) in the case of any successful action to enforce the foregoing liability, the costs of the action, together with a reasonable attorney's fee as determined by the court.

(b) Class action awards

In determining the amount of any award in any class action, the court shall consider, among other relevant factors—

- (1) the amount of any actual damages awarded;
 - (2) the frequency and persistence of failures of compliance;
 - (3) the resources of the depository institution;
 - (4) the number of persons adversely affected;
- and

(5) the extent to which the failure of compliance was intentional.

(c) Bona fide errors

(1) General rule

A depository institution may not be held liable in any action brought under this section for a violation of this chapter if the depository institution demonstrates by a preponderance of the evidence that the violation was not intentional and resulted from a bona fide error, notwithstanding the maintenance of

procedures reasonably adapted to avoid any such error.

(2) Examples

Examples of a bona fide error include clerical, calculation, computer malfunction and programming, and printing errors, except that an error of legal judgment with respect to a depository institution's obligation under this chapter is not a bona fide error.

(d) Jurisdiction

Any action under this section may be brought in any United States district court, or in any other court of competent jurisdiction, within one year after the date of the occurrence of the violation involved.

(e) Reliance on Board rulings

No provision of this section imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Board of Governors of the Federal Reserve System, notwithstanding the fact that after such act or omission has occurred, such rule, regulation, or interpretation is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

(f) Authority to establish rules regarding losses and liability among depository institutions

The Board is authorized to impose on or allocate among depository institutions the risks of loss and liability in connection with any aspect of the payment system, including the receipt, payment, collection, or clearing of checks, and any related function of the payment system with respect to checks. Liability under this subsection shall not exceed the amount of the check giving rise to the loss or liability, and, where there is bad faith, other damages, if any, suffered as a proximate consequence of any act or omission giving rise to the loss or liability.

3. Section 229.30 of Title 12, Code of Federal Regulations, provides:

§ 229.30 Paying bank's responsibility for return of checks

(a) *Return of checks.* If a paying bank determines not to pay a check, it shall return the check in an expeditious manner as provided in either paragraph (a)(1) or (a)(2) of this section.

(1) *Two-day/four-day test.* A paying bank returns a check in an expeditious manner if it sends the returned check in a manner such that the check would normally be received by the depositary bank not later than 4:00 p.m. (local time of the depositary bank) of—

(i) The second business day following the banking day on which the check was presented to the paying bank, if the paying bank is located in the same check processing region as the depositary bank; or

(ii) The fourth business day following the banking day on which the check was presented to the paying bank, if the paying bank is not located in the same check processing region as the depositary bank.

If the last business day on which the paying bank may deliver a returned check to the depositary bank is not a banking day for the depositary bank, the paying bank meets the two-day/four-day test if the returned check is received by the depositary bank on or before the depositary bank's next banking day.

(2) *Forward collection test.* A paying bank also returns a check in an expeditious manner if it sends the returned check in a manner that a similarly situated bank would normally handle a check—

- (i) Of similar amount as the returned check;
- (ii) Drawn on the depositary bank; and

(iii) Deposited for forward collection in the similarly situated bank by noon on the banking day following the banking day on which the check was presented to the paying bank.

Subject to the requirement for expeditious return, a paying bank may send a returned check to the depositary bank, or to any other bank agreeing to handle the returned check expeditiously under § 229.31(a). A paying bank may convert a check to a qualified returned check. A qualified returned check must be encoded in magnetic ink with the routing number of the depositary bank, the amount of the returned check, and a "2" in position 44 of the MICR line as a return identifier, in accordance with the American National Standard Specifications for Placement and Location of MICR Printing, X9.13 (Sept. 1983). This paragraph does not affect a paying bank's responsibility to return a check within the deadlines required by the U.C.C. Regulation J (12 CFR part 210), or § 229.30(c).

(b) *Unidentifiable depositary bank.* A paying bank that is unable to identify the depositary bank with respect to a check may send the returned check to any bank that handled the check for forward collection even if that bank does not agree to handle the check expeditiously under § 229.31(a). A paying bank sending a returned check under this paragraph to a bank that handled the check for forward collection must advise the bank to which the check is sent that the paying bank is unable to identify the depositary bank. The expeditious return requirements in § 229.30(a) do not apply to the paying bank's return of a check under this paragraph.

(c) *Extension of deadline.* The deadline for return or notice of nonpayment under the U.C.C., Regulation J (12 CFR part 210), or § 229.36(f)(2) of this part is extended:

(1) If a paying bank, in an effort to expedite delivery of a returned check to a bank, uses a means of delivery that would ordinarily result in the returned check being received by the bank to which it is sent on or before the receiving bank's next banking day following the otherwise applicable deadline; this deadline is extended further if a paying bank uses a highly expeditious means of transportation, even if this means of transportation would ordinarily result in delivery after the receiving bank's next banking day; or

(2) If the deadline falls on a Saturday that is a banking day, as defined in the applicable UCC, for the paying bank, and the paying bank uses a means of delivery that would ordinarily result in the returned check being received by the bank to which it is sent prior to the cut-off hour for the next processing cycle, in the case of a returning bank, or on the next banking day, in the case of a depositary bank, after midnight Saturday night.

(d) *Identification of returned check.* A paying bank returning a check shall clearly indicate on the face of the check that it is a returned check and the reason for return.

(e) *Depositary bank without accounts.* The expeditious return requirements of paragraph (a) of this section do not apply to checks deposited in a depositary bank that does not maintain accounts.

(f) *Notice in lieu of return.* If a check is unavailable for return, the paying bank may send in its place a copy of the front and back of the returned check, or, if no such copy is available, a written notice of nonpayment containing the information specified in § 229.33(b). The copy or notice shall clearly state that it constitutes a notice in lieu of return. A notice in lieu of return is considered a returned check subject to the expeditious return requirements of this section and to the other requirements of this subpart.

(g) *Reliance on routing number.* A paying bank may return a returned check based on any routing number designating the depositary bank appearing on the returned check in the depositary bank's indorsement.

4. Section 229.38 of Title 12, Code of Federal Regulations, provides:

§ 229.38 Liability.

(a) *Standard of care; liability; measure of damages.* A bank shall exercise ordinary care and act in good faith in complying with the requirements of this subpart. A bank that fails to exercise ordinary care or act in good faith under this subpart may be liable to the depositary bank, the depositary bank's customer, the owner of a check, or another party to the check. The measure of damages for failure to exercise ordinary care is the amount of the loss incurred, up to the amount of the check, reduced by the amount of the loss that party would have incurred even if the bank had exercised ordinary care. A bank that fails to act in good faith under this subpart may be liable for other damages, if any, suffered by the party as a proximate consequence. Subject to a bank's duty to exercise ordinary care or act in good faith in choosing the means of return or notice of nonpayment, the bank is not liable for the insolvency, neglect, misconduct, mistake, or default of another bank or person, or for loss or destruction of a check or notice of nonpayment in transit or in the possession of others. This section does not affect a paying bank's liability to its customer under the U.C.C. or other law.

(b) *Paying bank's failure to make timely return.* If a paying bank fails both to comply with § 229.30(a) and to comply with the deadline for return under the U.C.C., Regulation J (12 CFR part 210), or § 229.30(c) in connection with a single nonpayment of a check, the

paying bank shall be liable under either § 229.30(a) or such other provision, but not both.

(c) *Comparative negligence.* If a person, including a bank, fails to exercise ordinary care or act in good faith under this subpart in indorsing a check (§ 229.35), accepting a returned check or notice of nonpayment (§§ 229.32(a) and 229.33(c)), or otherwise, the damages incurred by that person under § 229.38(a) shall be diminished in proportion to the amount of negligence or bad faith attributable to that person.

(d) *Responsibility for certain aspects of checks*—(1) A paying bank, or in the case of a check payable through the paying bank and payable by another bank, the bank by which the check is payable, is responsible for damages under paragraph (a) of this section to the extent that the condition of the check when issued by it or its customer adversely affects the ability of a bank to indorse the check legibly in accordance with § 229.35. A depositary bank is responsible for damages under paragraph (a) of this section to the extent that the condition of the back of a check arising after the issuance of the check and prior to acceptance of the check by it adversely affects the ability of a bank to indorse the check legibly in accordance with § 229.35. Responsibility under this paragraph shall be treated as negligence of the paying or depositary bank for purposes of paragraph (c) of this section.

(2) *Responsibility for payable through checks.* In the case of a check that is payable by a bank and payable through a paying bank located in a different check processing region than the bank by which the check is payable, the bank by which the check is payable is responsible for damages under paragraph (a) of this section, to the extent that the check is not returned to the depositary bank through the payable through bank as quickly as the check would have been required to be

returned under § 229.30(a) had the bank by which the check is payable—

- (i) Received the check as paying bank on the day the payable through bank received the check; and
- (ii) Returned the check as paying bank in accordance with § 229.30(a)(1).

Responsibility under this paragraph shall be treated as negligence of the bank by which the check is payable for purposes of paragraph (c) of this section.

(e) *Timeliness of action.* If a bank is delayed in acting beyond the time limits set forth in this subpart because of interruption of communication or computer facilities, suspension of payments by a bank, war, emergency conditions, failure of equipment, or other circumstances beyond its control, its time for acting is extended for the time necessary to complete the action, if it exercises such diligence as the circumstances require.

(f) *Exclusion.* Section 229.21 of this part and section 611(a), (b), and (c) of the Act (12 U.S.C. 4010(a), (b), and (c)) do not apply to this subpart.

(g) *Jurisdiction.* Any action under this subpart may be brought in any United States district court, or in any other court of competent jurisdiction, and shall be brought within one year after the date of the occurrence of the violation involved.

(h) *Reliance on Board rulings.* No provision of this subpart imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Board, regardless of whether the rule, regulation, or interpretation is amended, rescinded, or determined by judicial or other authority to be invalid for any reason after the act or omission has occurred.